



23 August 2022

President's letter to the membership

Heritage Estates Property Owners Association

302 River Sound

West Jefferson, NC 28694

Dear Members,

HEPOA continues to make improvements in self-governance and transparency. In 2020, as we were attempting to update our governing documents, the Board of Directors became aware of North Carolina laws that govern creating and operating HOAs, several which we were not meeting. To identify compliance problems, the Board of Directors began review of HEPOA elections, records, minutes, and financial documents. The process has accelerated in the last 12 months as four new members (D. Esarey, J. Nowak, M. Nowak, P. Shepherd) joined the Board of Directors via election and appointment (see the attached list) to join the work on these challenges. In March 2022 the association's records were transferred to new Officers, reorganized, and converted to electronic files.

The Board has made important changes due to laws, insurance requirements, and risks to HEPOA. The process is not yet complete. HEPOA is a corporation, and all lot owners are members of this corporation. Although management is delegated to elected Directors, all of us are responsible for ensuring the Directors attend to the corporation's status and functions.

Compliance and accountability/transparency changes completed or underway include:

2020 Elections: HEPOA Board elections had not met state standards and thus all governing documents and amendments carried out by the Board were invalid (see the attached history of governing documents). The first step was taken when the membership properly elected the entire board at the 2020 annual meeting.

2021 Liability Insurance: Review showed that our liability insurance remained a holdover from the Developer's policy and was invalid, since it insured a for-profit developer corporation with 26 lots (the number of lots the second Developer received to sell) with specific coverage for company vehicles and advertising. This was converted to an HOA policy in 2021.

2021 Restrictive Covenants: Since both previously amended Covenants (2009 and 2013) were determined invalid on multiple points, the Board, under the leadership of Dean Moore and Janet Johnson, and guided by the advice of an attorney, spent much of 2021 working towards amending the original 1999 Restrictive Covenants (aka Declaration).

The Board properly voted, notarized, and filed them with the Ashe County Register in November 2021.

2021 Annual Budget: Review showed that HOA members must approve an annual proposed budget (§47F-3-103c), both for operating expenses and for any new purchases or projects. As of the 2021 annual meeting, HEPOA is operating under a member-approved annual budget and will continue to do so.

February 2022 Audit: The Board had an Agreed Upon Procedures Audit (review of specific financial aspects) completed 25 February 2022. Finances for 2018 through 2021 were examined. Proof of cash, bank statements, invoices, receipts, payments, expenses by category, and the tax filings provided met legal standards.

March 2022 Banking: With the February 2022 election of a new Treasurer and Assistant Treasurer, HEPOA accounts needed to be examined and signatories changed. It was discovered that, in 2008, HEPOA had merely added our first Treasurer as a signatory to the developer's money market account used for operating expenses. For our first four years this account still had the developer's tax ID and listed the developer's Articles of Incorporation, and thus still belonged to the developer. In late 2011, the tax ID on the account was changed to HEPOA's tax ID. Discovering that the developer's corporation had been dissolved with the Secretary of State in 2007 and having no notice from HEPOA of its own incorporation, the bank had converted the account to a personal rather than corporate money market account.

As a personal account, the original 2011 HEPOA Board signatories (R. Wall, J. Moore, J. Landen) could now be neither removed nor added to. Although HEPOA's policy required two signatures, the bank did not. In March 2022 the HEPOA personal money market account was closed. A new corporate checking account for HEPOA was opened for operating expenses with the HEPOA tax ID and, for the first time, Articles of Incorporation.

April 2022 Reserve Study: According to state law (§47F-3-114) reasonable operating expense surpluses can be maintained or paid into Reserves funds. But a reasonable annual operating margin and the annual transfers into the Reserve Account should be defined and justified in the Bylaws. And a Reserve Study should provide information that justifies reserve savings by documenting and projecting non-annual costs, such as those needed for maintaining common property. HEPOA now has such a study, and it is based on past financial records. It is available on the website or by request.

June 2022 Reserve Fund Management: In 2012 members voted on a raise of the annual assessment by \$100 and were told (December 2012 letter to membership) that all the raised dues would go into the Reserve account. When the raised dues took effect in 2013, only 40% of the increase was deposited in the Reserve account. The remaining 60% of the increase was used for operating expenses some years and sometimes accumulated in the annual operating account. Additionally, some reserve-eligible maintenance has been classified as annual operating expenses. The balances have been

determined, and funds have now been retroactively reapportioned to the Reserve account to realize the Reserve savings plan from 2012.

July 2022 Reserve Banking: The HEPOA Board opened its Reserve savings as a checking account in 2009, believing that our HOA was not allowed to earn interest on our Reserves. This was in error. The Board has now closed the HEPOA Reserves checking account and opened a savings account for the Reserve Fund.

July 2022 Fidelity Insurance: Although called for in the original HEPOA bylaws, the Board had not to date obtained theft/fidelity insurance because it was too expensive. We obtained a quote of \$530+ per year in 2020. Having now adopted the fiscal controls listed in the insurance application checklist, we have purchased this policy at an affordable cost of \$220 per year. Our fiscal procedures are available from the website or by request.

July 2022 Board Insurance: Our Directors and Officers (D&O) insurance (purchased about 2013) was not valid because the application contained incorrect information. Our D&O policy was for a Property Owners Association that specifically did not allow vacation rentals. We are an HOA with vacation rentals. Also, there are important corporate distinctions between a property owners association and a home owners association. In spite of our name, we are a home owners association. HEPOA now has a valid D&O policy with correct information. (This policy protects HEPOA corporate funds from lawsuits regarding errors made by the Directors.)

July 2022 Required Policies: The new D&O insurance specifically requires we have Anti-Harassment and Conflict-of-Interest written directives. As of July 2022, these have been adopted and are available on the website or by request. The Conflict-of-Interest policy requires a signature by each Director, which has, and will continue to be done.

Currently underway - Bylaws: As outlined in the Restrictive Covenants, a duly elected Board of Directors can write and distribute the original Bylaws of an HOA, while subsequent revisions must be approved by a majority of the members. Both versions of the HEPOA bylaws (2009 original and 2016 revisions) were invalid because of the methods used to adopt them (see attached history of governing documents). The Board continues to work on rewriting the bylaws. Membership approval is not technically needed for the first valid set of Bylaws, but given the circumstances, they will be presented for member vote. This task is not yet complete.

Currently under consideration – Vacation Rentals: HEPOA is a non-profit corporation that is NOT tax-exempt. HEPOA files an 1120-H IRS form that allows us to avoid paying taxes on our income if we meet 3 requirements. We easily meet two of them. The third requirement is that at least 85% of the houses must be classed by the IRS as residences. According to IRS definitions, leased or rented houses are residences. **A vacation rental can be classed as a “residence” if the owners use it themselves for at least 10% of the number of days it is rented per year. Currently, 15% of our houses would amount to 3 houses which are not meeting this definition.** HEPOA has no policies in our governing documents regulating the right to make a house a vacation rental, nor even register that

fact with the HOA. North Carolina courts have generally ruled against HOAs that try to create restrictions on rentals after lots or homes have been purchased. If we were to exceed the 15% residence requirement even a single time, HEPOA would have to pay a flat 30% tax from now on. The Board needs to work closely with members using their homes as vacation rentals to make sure we do not exceed the conditions that would lead to this permanent IRS reclassification. We are still working on a solution to this.

Currently under consideration – dues consolidations: The Board is considering the legal and financial issues of dues in relation to lot consolidations. In constructing the first proposed annual budget (for 2022), the Budget Committee found it difficult to understand annual operations, especially because of how income was reported. Dues paid before rather than after January 1 were reported in different years. The new Treasurer has now created an electronic document consolidating all the assessment information. This makes very clear the effect dues reductions for consolidated lots have had.

In 2014, 2017, and 2020 a total of eight lots were consolidated and registered with the county to change their boundaries. Their dues reduced to 3 memberships. The methods of these dues reductions do not appear to match dues reductions done by the Developer, as was allowed in the HEPOA Restrictive Covenants. To date there has been no formal Board action reviewing or approving these changes. In addition to HEPOA's Covenants/Declaration regulating this, relevant North Carolina laws and court decisions pertain. In general, the state has determined HOA dues extinguishments are an infringement of the proportional responsibilities of other lot owners' dues. **Unless specifically allowed in the Covenants/Declaration lot consolidations on their own merit do not constitute a sufficient elimination of the dues/assessment obligations that run with the land for each lot.** HEPOA governing documents do allow for the developer to change lot boundaries and may set very specific conditions for members to follow the same course. The Board will be obtaining legal advice on a proper course of action going forward. This issue is explored in more detail in the attached review by the current President.

Notices:

Annual Report: A Second Annual Report detailing the above, and more routine, matters will be distributed at the 2022 annual meeting, posted on our web site, and emailed/mailed to members not in attendance.

We are currently financially sound and can operate within our annual budget. The scope and future viability of our initial Reserve account are now projected and available for member review (by request or web access). **The proposed 2023 Annual Budget is attached and will be ratified or rejected at the Annual Meeting.**

Records Access: As part of the book-keeping changes described in the Annual Budget for 2023 and the transfer to a new Treasurer, the HEPOA financial records from 2008 to the present are now fully electronic. Physical records are organized and archived at the Treasurer's residence. Backing up the Association's records via scanning is also

underway. **Members have the right to examine all Association records upon demand. Electronic access will facilitate that process as needed.**

Hope to see you (or your proxy votes) all at the Annual Meeting!

Duane Esarey
President (2022-2024)
Heritage Estates Property Owners Association

Attachments:

- HEPOA Annual Meeting Notice
- 2023 Operating Budget (for member ratification at the Annual Meeting)
- HEPOA History and Validity of Governing Documents
- HEPOA's covenanted membership obligations and processes for dues extinguishments
- Current Directors and Officers